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SUBJECT: ROMANIAN STOCK MARKET SEARCHES FOR A COMPETITIVE EDGE

1. (U) Summary: Battered by the same negative forces affecting stock markets worldwide, the Bucharest Stock Exchange (Bursa de Valori Bucuresti, or BVB) is struggling to capitalize on Romania's strong economic growth in order to maintain a competitive position. To boost investor confidence, BVB management is cutting fees, drafting a corporate governance code for listed companies, and launching new financial products. Holding on to foreign portfolio investors will be crucial for offsetting a 20% drop in the main index last year. Despite overall profitability for the companies listed on the exchange (net aggregated profit was up 75% against the first quarter 2007), global market uncertainty has increased competitive pressures on the BVB and forced it to expand into new areas. End summary.

DESPITE MARKET CHALLENGES, REASONS FOR OPTIMISM

2. (U) Overall, Romania's capital market has weathered recent international turmoil in reasonably good shape. Despite a fall in the BET index (the ten most frequently traded stocks on the exchange) of 20.8% in the first quarter of 2008, other indexes posted less severe declines. The BET-C index (all the stocks minus five investment funds) fell by a more modest 16.9%, while the RASDAQ (which covers the Over the Counter (OTC) market) was down only 5.5%.

(Note: The OTC market provides a mechanism for trading unlisted stocks in public companies. End Note.) A leading factor in the indices' decline was the mood of international portfolio investors, who despite Romania's robust economic growth are skittish over rising inflation and current account imbalances. In the first quarter of 2008, net flows were negative by 42.9 million dollars, compared to plus 246.7 million dollars during the first quarter, 2007. At the same time, the value of foreign portfolio investors' net buys totaled only 89.3 million dollars, down substantially from 363.5 million in the first quarter of last year. Still, stimulated by strong growth in domestic companies, the BVB's market capitalization managed to rise by a third (compared to Q1 2007) by the end of the first quarter to 53.4 billion dollars.

3. (U) Other measures of activity were mixed. The number of equity issuers on the BVB rose from 59 at the end of 2007 to 64 at the end of April 2008, while the number of issuers on the RASDAQ index fell from 2,019 to 1,872. Yet, in spite of the fact that many BVB-listed firms posted positive financial results, the average price-to-earnings ratio fell 22% compared to first quarter 2007. Out of the 63 BVB issuers, only 16 reported losses at the end of the first quarter 2008, while the aggregate net profit was up 75% against the same period last year. The firms reporting losses were in the chemicals, materials and equipment sectors. In contrast to leading world indexes, banking stocks in Romania have experienced a good period; all of the banks listed on BVB reported net profits up at least 50%.

MORE TRANSPARENCY NEEDED TO BOOST INVESTOR CONFIDENCE

4. (U) In a June 9 meeting with econoffs, BVB President Stere

Farmache said that the BVB management wants to increase corporate transparency, especially for firms on the RASDAQ index. Additional business may be generated by the BVB's intention to place 400-500 firms in a new "RASDAQ-Start" category. These companies will be considered "traded but not listed" for up to nine months, during which time they will receive assistance from the BVB to meet the listing and transparency requirements in place for other listed companies. The expectation is that by offering help and demonstrating the benefits of being listed, BVB will succeed in getting many of the companies fully listed by the end of the period.

Another initiative to boost transparency on the primary market is to require listed companies to adhere to a Corporate Governance Code based on either on a model code drafted by the BVB, or on any other model code in use in the EU.

#### OTHER REGIONAL EXCHANGES POSE STIFF COMPETITION

15. (U) The BVB must diversify offerings, attract new issuers, and upgrade the trading platform (the new platform, Arena Gateway, will improve data flow between brokers and the exchange) in order to remain competitive with other stock exchanges in the region. Competition stems from the ability of Romanian brokers to trade directly on the Frankfurt Futures Market (EUREX) and the Vienna stock exchange. In response, BVB management has cut trading fees by 10% and IPO fees by 75%. They have also increased the length of the daily trading session. Liquidity will be enhanced through the addition of two new indexes, an energy and utility index (BET-NG) and an "extended" index (BET-XT), which will feature the same stocks as the BET plus five large, state-chartered investment companies (SIFs).

16. (U) Plans are in place to expand the BVB through additional offerings. Romanian treasury bills will be listed on the exchange

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by the end of this year. Another large equity listing anticipated in 2008 will be for a minority share of Bucharest's Otopeni International Airport. Finally, the newly-established Property Fund will list on the exchange in 2009, and is expected to provide a significant liquidity boost. (Comment: Shares in the Property Fund are distributed to all persons who were entitled to restitution of property seized in the Communist period, but whose property cannot be restored to them for various reasons. The Fund contains shares of many of the major state-owned company privatizations in Romania, including "blue chips" like Romtelecom and Petrom. End Comment.)

17. (U) Another area of BVB expansion launched last September is derivatives trading. The first derivatives available were those on indexes, but they proved unpopular, attracting only 41 transactions and 64 contracts, reaching a total value of USD \$227,115 by the end of 2007. In order to revive this market, the BVB in April 2008 cut fees and launched futures contracts linked to select listed shares and currencies (both EUR/RON and USD/RON). With these changes, the futures exchange has posted 264 trades and 4,034 contracts, for a total of USD \$1.8 million this year.

#### COMMENT

18. (U) Despite the instability so far this year stemming from international market woes, BVB management appears to have a good plan in place to succeed in a competitive marketplace. Romania's rapidly growing domestic economy has afforded the BVB a cushion, enabling it to ride out the current turmoil even if not remaining immune from its negative effects. BVB's plans for expansion seem reasonable and coherent, and expectations are that the exchange will remain profitable. Still, the competitive threat is real. With capital able to move freely across EU borders, the exchange will have to stay nimble to keep Romanian "blue chip" companies from listing on other European exchanges.

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